WORLD CHRONICLE

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PROGRAMME: **"WORLD CHRONICLE"**

GUEST: Lance Taylor
United Nations University

JOURNALISTS: Paul Lewis, The New York Times
Claude Robinson, Inter Press Service
Bhaskar Menon, PTI-TV India

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SYNOPSIS

Reverse Capital Flow

Lance Taylor, Research Advisor to the World Institute for Development Economics Research, a branch of the United Nations University, and a Professor at MIT, the Massachusetts Institute of Technology, suggests that a mere $40 billion in capital each year, just one-third of one percent of the affluent world's income, could raise annual growth rates in poor countries by more than one percentage point. However, Professor Taylor cautions that in order to get the resources developing countries will have to demonstrate that they can manage the capital efficiently.

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VOICE From United Nations Headquarters in New York, this is World Chronicle, an unedited interview programme about major global issues. Here now to introduce our guest is the host of today's World Chronicle.

LITTLEJOHNS: I'm Michael Littlejohns and this is WORLD CHRONICLE.

A report entitled "Foreign Resource Flows and Developing Country Growth" has just been issued by the World Institute for Development Economics Research or WIDER, a branch of the United Nations University in Helsinki. The report envisages a return of developing nations to a path of socially necessary growth in the '90s, namely economic growth rates that can provide people with basic needs, reduce unemployment and improve income distribution. Is this achievable? What are the essential ingredients for making this a reality?

Our guest today, Lance Taylor of the United States, is the author of the report and a Research Advisor to WIDER, a branch of the U.N. University. He is also a professor at MIT, the Massachusetts Institute of Technology. Prof. Taylor will be interviewed here at United Nations Headquarters in New York by: Paul Lewis of The New York Times; Claude Robinson of Inter Press Service; and Bhaskar Menon of PTI-TV, India.

For some background information, here's a report from our correspondent, Steve Whitehouse.

WHITEHOUSE: The 1980s have been an economic disaster for many Third World countries. The common perception that developing countries are net recipients of capital

and finance from the industrial nations is no longer true. Today, a massive flow of capital, a net outflow of $20-$40 billion a year, leaves the Third World. Why?

Falling commodity prices, slowing growth rates and high interest rates have wreaked havoc in many Third World economies. Most poor countries are hopelessly in debt, with some nations devoting half or more of their export incomes to just paying interest in precious hard currency.

Loans are becoming difficult to get. Many commercial banks are reluctant to lend money. The scarcity of funds is made even tighter by domestic capital flight. Instead of putting money in local banks, many people in the developing world have transferred their assets out to foreign banks.

Reduced foreign reserves deeply undercut a country's economic capacity. Farmers, for example, might be forced to cut grain production worth $1 million for want of imported fertilizer costing $100,000. Ultimately, it's the people who suffer.

Most of Africa and much of Latin America's average incomes have fallen by as much as 25% during the 1980s. In the 27 poorest nations, expenditure on education has also been reduced by a quarter. And spending on health has declined by 50%.

Failure to cushion the poor from the impact of reduced social and public spending has set off social unrest, making foreign bankers even more wary to invest in the countries of the South.

A recent United Nations University report says $40 billion each year, just one third of one percent of the affluent world's income, would put the Third World back on an economic growth path. This proposal comes at a time when global demand for capital is on the rise. But an increase in the world's capital resources, devoted to development, is vital to an economic revival in the South, where population is expected to double in the next 30 years. The key question is: are rich nations ready to reverse the flow of capital out of the Third World?

LITTLEJOHNS: Prof. Taylor, I'm sure that most people are very concerned about the problems of the poor in the developing world but how much of the problem is attributable to mismanagement and corruption?

TAYLOR: Well, giving a quantitative answer is obviously impossible. It's an important factor but I think equally important, perhaps more, are the external shocks that developing countries have had during the 1980s, that is terms of trade have fallen by 40% or 50% in Africa which has cut the value of their exports by that much. Export volume has declined as well. In Latin America there was a transfer on credit account to the region of something like $25 billion per year up until 1982. That switched to $50 billion the other way in 1985 and it's still running about $25 billion from Latin America to the rest of the world now. Those kinds of external shocks which have been as large as five percent of GDP and five percent or more of GDP in these countries are almost certainly going to lead to recession, inflation and other kinds of things you're seeing. Corruption flourishes in those circumstances and plays a role but I don't think it's an essential factor.

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LITTLEJOHNS: You talk about throwing another $40 billion at the problem, is that going to solve it?

TAYLOR: No. I wouldn't say throwing $40 billion. I think $40 billion could be effectively utilized by these countries but even $40 billion would only let their capacity grow by about one percent extra per year to get back to historical growth rates, particularly in Latin America and to a certain extent in Africa, and you're probably talking about $60 billion or $80 billion.

LITTLEJOHNS: Are there enough competent people in these countries to use this large sum of money usefully?

TAYLOR: It depends on the country. I would say in Latin America definitely so, in some African countries it would also be true, in other African countries it would be tricky.

LEWIS: I want to follow the same line of questioning a bit. You put a lot of emphasis on aid and giving more money to these countries but I have the impression that the fashionable idea in development economics now is to put emphasis on the policies which governments follow and to say that poor countries will only grow richer if they follow the correct kind of domestic policy, so how important do you think policy change is as against aid flows?

TAYLOR: Well, there are two issues involved there. One is there is a necessity for additional aid flows and even the people who are recommending major policy changes -- and by that I would think of the World Bank and the IMF -- would agree on that point. I think you used the word fashionable? I think that that's probably a bad word. There's a certain notion that's very popular in this country among people who sit in

Washington, D.C., that the only solution to development problems is something like a free market solution with not too much government policy intervention and that's what people mean when they say that they want to improve policy in the developing world. I think that's basically wrong and this sort of Bank/Fund position also needs modifying in that direction.

LEWIS: Why do you think it's wrong? Are you prepared to go as far as some of these people who say that democracy is a necessary pre-condition for development?

TAYLOR: I think democracy is very helpful for development yes but not possibly a pre-condition but certainly there are cases at all income levels where democracy and development go together.

ROBINSON: Prof. Taylor, you're talking as you said about getting growth levels improved by just one percent which in effect would not get it back to the historical levels, but even at that one percent $40 billion is just about the amount of money that developing countries are now transferring per year to the industrialized countries. Given the United States' appetite for foreign capital in order to deal with its own imbalances and its own budget problems is it realistic for us to expect that the developing countries can attract this kind of capital?

TAYLOR: I'm not sure it's realistic in the short run. One reason why we did the paper, however, was to emphasize the fact that poor countries have really received enormous macro economic shocks during the 1980s and it's important I think to put that on the table. Now, I think the U.S. comparison is in fact very interesting that these countries as I mentioned were taking shocks on the order of five, six, seven percent of GDP in terms of changes in net credit flows, losses of terms of trade,

etc. If you compare the sort of wailing and gnashing of teeth that comes out of the United States when Congress is worrying about reducing the U.S. deficit by something like a half percent or one percent of GDP, you see the magnitude of the difficulty that developing countries have had to face.

ROBINSON: Are there are countries or any regions that you have found that are more likely to be able to attract capital, that is to say to absorb it and use it effectively and therefore be more acceptable or more attractive to the foreign investor?

TAYLOR: Well, there's a difference between attracting and absorbing. At the moment countries in South East Asia -- Thailand, Malaysia -- are both attracting a lot of capital which the largest end is coming from Japan and they're able to absorb it. Countries in Latin America -- Mexico, Brazil -- if capital either from third party donors or even flight capital would begin to go back into those countries they could also absorb it. In Africa, which at the moment is receiving something like $6 billion in aid flows per year, if that were to go up to let's say $10 billion or $12 billion, I think in most countries you'd run into sort of big absorption problems in terms of lack of available government functionaries to carry out the projects and that sort of thing. So it's a mixed situation. It depends on what's happening in the economy and also what's happening on the supply side.

MENON: It's been historically true that appeals to altruism have never succeeded in getting the rich to part with their wealth and in the early '70s, in the history of international negotiations on this topic, the developing countries realizing this came up and said at the U.N. that the whole world system is iniquitous and needs to change. Now that

kind of talk has completely disappeared and you find people saying it's all the fault of the developing countries policy makers. How does this report fit into that debate?

TAYLOR: Well, I'd say if you believe that, that's the general thrust of the debate that the developed world has finessed the developing country pressure very effectively. No, I believe that in effect the developing countries in many ways have the cards stacked against them. There are things they can do about that. You can learn to export commodities that have high demand in advanced countries for example, follow the Korea/Taiwan paths which Thailand is now going into, but that kind of development is not open for everybody in the world.

MENON: No, but don't you think that the rules change as soon as a group of developing countries begin to become competitive in some area, the rules change either quite subtly by the raising of trade barriers, or quite openly as in you know blanket rules, like the multi-fibre agreement which basically says, "Look these things are not covered by GATT anymore, we have to have a separate agreement"?

TAYLOR: Oh sure, there's no question rules change but that doesn't mean you should stop pushing. I mean so they change rules one way and you do something else. You've got to learn how to do that if you're going to get ahead, there's no question about that.

LEWIS: You say that you want this extra aid, this extra $40 billion a year. Now it seems to me it's going to be very difficult to get this out of the Western parliaments -- I mean the current political climate -- so my question is would it be possible to achieve the same effect by forgiveness of debt and cancellation of interest payments from developing countries to the industrialized world?

TAYLOR: Yes, sure. In terms of specific modalities you'd have to think of several lines to follow. For Africa I think simply cancellation of debt from the bilaterals and most bilateral donors would make sense. I mean, you're talking about $30 billion or $40 billion of total debt, a third of a day of GDP in the Northern economies and that's not too hard to forgive that. For the Latin American countries, you've got to think, I think in terms of a much bigger Baker Plan. The Baker Plan goes in the right direction but it's basically a drop in the bucket that Latin American countries out of the Baker Plan as a recent report from the Economic Commission for Latin American and the Caribbean shows, will get something like $4-$5 billion per year. For historical growth rates, they would need something like $15 billion per year. A larger Baker Plan, better provision for return of flight capital into the countries which have suffered from capital flight, maybe over time some renewal of the commercial bank lending -- although I don't see that very much happening before let's say the year 2000 -- there are various channels that could be explored and if policy makers were to push in that direction then I'm sure they could find something to do.

ROBINSON: Was that Baker or Brady?

TAYLOR: Oh, I'm sorry. Brady, yes. Not too much difference.

LITTLEJOHNS: The Secretary of the Treasury not the Secretary of State.

The programme is **WORLD CHRONICLE.** Our guest is Lance Taylor, Research Advisor to the World Institute for Development Economics Research, a branch of the United Nations University.

ROBINSON: In the 1960s much of the foreign investment in developing countries was mainly in resource extraction industries -- in mining, in oil, and so on -- now with technology shifting both in terms of materials and energy, based on what you've done, what are the areas that you think are more likely to be areas in which the private investor would be interested in developing countries?

TAYLOR: I think that again if you look at the South East Asian countries, you'll see massive private investment flows largely coming from Japan and also private investment flowing between those countries largely in middle level manufacturing assembly operations, some pollution intensive industries which the Japanese are beginning to put offshore. In that corner of the world, I think you'd probably see expansion of basically industrial direct private investment. In the poorer countries, I think it will probably still be in the resource extraction area, although, as you point out, one thing that's implicit in what you were saying is that there are strong trends against use of extractable resources in manufacturing processes both in the North and the South, and that's a tendency that does not bode well, especially for the poorer countries in the world.

MENON: The International Monetary Fund has just agreed to increase its quotas, in other words to increase the resources that will be available for balance of payments support for developing countries, and for all countries generally, do you see this as having any impact on the development situation and if so, to what extent would it go towards meeting the $40 billion payments?

TAYLOR: I think it's an important step. I mean the Fund, when it comes to a country, effectively runs a recession to put it bluntly when they suggest fiscal austerity, devaluation, other kinds of policies, all of which are quite contractionary. Historically, when the Fund has had more money the country economists have been sort of slightly less enthusiastic about running recessions when they come and in that sense, the additional resources of the Fund, these resources have to be approved by the national governments and be ratified in this country, but I think it will probably improve somewhat the situation.

MENON: I understand that the rules of the IMF will also change in the setting up of support groups of countries to get countries in arrears out of debt, will that have an appreciable effect?

TAYLOR: The number of countries that are actually in arrears of the Fund -- I don't know the exact number off the top of my head right now...

MENON: It's eleven.

TAYLOR: Is it eleven? Yes. They are reasonably small countries with reasonably small debts and putting in effect a procedure by which they can get out of arrears I think would be a very useful thing to do. The Fund is by no means a Santa Claus and I think in many cases the policies they recommend are wrong but nonetheless, when they have more resources, they tend to be a little bit less wrong and in that sense is a useful step.

LEWIS: You point out that there are quite a number of competing demands for capital in the world for money -- it's just not developing countries. You also emphasized the sudden arrival, as big borrowers, of the East European countries as they try to modernize their economies to take part in the Western economic system so my question is, is this wholly bad for the developing world or in a while will we see that the East European countries become new sources of demand for raw materials from the Third world and also themselves begin to take part in the aid process, giving aid and transferring technology to developing countries?

MENON: I wouldn't foresee that for at least ten years that the East European countries are going to have a very difficult adjustment. I would guess that recession in Poland for example is going to go on for maybe three years before they begin to come out of it. They can absorb a lot of money at that time, during that period, but they're aren't going be giving very much out.

ROBINSON: If I could follow up on that. There has been a lot of talk recently about the so-called peace dividend and that with the reduction in military spending that much resource, or at least some resource, would be available for investment in developing countries as also for reducing for instance the deficits in the United States, how did your study factor this into account? Did you take this into account and if so, what did you find?

TAYLOR: No, we consciously tried to look at the question from the angle of developing countries. Just asking how much external resources would they need, what degree of fiscal reform would they have to undertake, what kind of other macro economic policies could they consider to try to restore a more reasonable growth path.

ROBINSON: But on fiscal reforms as you know practically every developing country has introduced all kinds of tax incentives and other incentives in the last couple of years to attract foreign direct investment, yet this has not happened. Are there any gaps that you found that they should be plugging?

TAYLOR: Well, what I meant by fiscal reform is the following: that particularly in Latin America the debt, the foreign debt, essentially has been nationalized so that for a country to pay off its foreign debt obligations it has to run a trade surplus to get the dollars to pay and since the government owes the debt, the government also has to run a fiscal surplus or has to cut back other spending and one of the dilemmas the countries find themselves in, is that a lot of the spending cut backs have taken place in public investment. Now, in fact, public investment positively affects or crowds if you like private investment in developing countries so as public investment has gone down, private investment has gone down, there's really no capital, no net capital formation in many parts of the world, and that's a fiscal problem.

MENON: On the whole, are you positive or negative about the situation now as far as development goes? Do you think the developing countries will get the $40 billion?

TAYLOR: In the short run I don't think so. I think there are possibilities for improvement in the situation over the decade, that is -- if I get the name of the author right -- if the Brady Plan were to spend properly, and if there were to be some repatriation of flight capital, some consciousness of the great needs in Africa.I think there is ....

MENON: But what do you think they need to do? What do you think developing countries need to do in order to improve their situation?

TAYLOR: I think developing countries obviously have to demonstrate a need and they also have to show competence, as someone pointed out, in using the resources that come in. The more that they do that -- run effective investment projects, start putting out additional exports, generating tax revenues -- then I think that's going to improve the climate of opinion and free up more resources.

LEWIS: Supposing that the Western industrialized nations did make this effort and did transfer the extra $40 billion in aid, what would the effect be on them and their economic situation? Would this push them into higher interest rates and recession and so on?

TAYLOR: That's a very good question to which nobody in my fractious profession has a very good answer. What I can say is the following, that the world macro economic system tends to be very sensitive to little teeny tiny shocks of about $100 billion a year. That is if you look at the first oil shock or the US trade fiscal deficit, that's about $100 billion, and the world system has proven highly sensitive in terms of interest rates, inflation rates, and output levels to that kind of a shock. Now, we're really talking about the transfer of that magnitude to developing countries and I think it would be very important to explore the implications. Nobody has done that probably and that's something that people should worry about.

ROBINSON: The economists and development experts have come up with various things or ideas, suggestions, policy prescriptions for developing countries over the years. It's

build dams, it's build highways, it's educate your people. Sometimes one gets the impression that there is a whole, as it were, theology that is of expertise out there which is self-perpetuating and the same people who come up with one idea today it's wrong and they turn around tomorrow they come up with another idea, it's equally wrong. Why should anyone in a government in any developing country listen to any of you people?

TAYLOR: Why should anybody listen to an economist is a better question. No, I agree that there are fads and fashions. The reason why developing country people have to listen to what these crazy palefaces have to say in part is because the palefaces have lots of money in their pockets and if I come into a country with a $100 million then I guess you've got to listen to me even if half of what I'm saying is crazy. That's the reality of the situation. I think that in particular the Bretton Woods institutions -- the Bank and the Fund -- for example went way overboard during the 1980s on suggesting free market, get your prices right solutions. They're now backing away from that, maybe taking a better look at history and institutions and trying to design more reasonable programmes, but I agree with you basically.

MENON: Well, to take up the same theme, economists are essentially the witch doctors of the modern world and they're effective as long as people have faith in what they say, and governments have faith in what they say. You, or economists like you, who plead for the poor essentially have no power and therefore people have no faith in what you say. Is that part of the problem?

TAYLOR: Is that part of it? No, I think that probably the key problem was economics in the '80s. The '70s and '80s has been a lack of appreciation of history and the lack

of appreciation of institutions. Economists like me, if we say anything, we're saying that the way, the only way, that any country can ever hope to develop is designing policies in terms of the history and institutions that exist there and sort of being rather less arrogant about prescribing the way the world works than economists have been. I think I'm right in saying that. I think the tendency in the profession is going that way but it will take a while to surface I'm afraid.

LEWIS: What can you say about the effectiveness of aid because I mean you are asking for more aid, yet aid fatigue exists in the West. People are very cynical about it. Recently the World Bank published a report and it admitted that a large amount of money which it has spent, particularly on agricultural products, have all failed, so how effective is aid?

TAYLOR: I think aid is the wrong word. I'm really talking about reversing the resource transfer of sort of $40 billion that's going from the South to the North and driving it back down something closer to zero. Now what if that reversal takes place in the form of more aid, an expanded Brady Plan, lower interest rates, more direct foreign investment -- all these channels will have to be explored. Countries, if they don't have to run recessions and run inflations to deal with 5% balance of payment shocks, will automatically look better.

ROBINSON: Speaking of aid... Sorry, Michael are we out?

LITTLEJOHNS: Claude, I think we're practically out of time so I don't think you better throw another question at Prof. Taylor.

Prof. Taylor, you've been a very interesting guest and I'm sure that we've learned a lot on a very important subject. That's all the time we have. Thank you for joining us on this edition of **WORLD CHRONICLE**.

Our guest has been Lance Taylor, a Research Advisor to the World Institute for Development Economics Research, a branch of the United Nations University. He was interviewed here at United Nations Headquarters in New York by: Paul Lewis of The New York Times; Claude Robinson of Inter Press Service; and Bhaskar Menon of PTI-TV, India.

I'm Michael Littlejohns. Thank you for joining us. We invite you to be with us for the next edition of **WORLD CHRONICLE**.

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